KRS MEMBER NEWS

Kentucky **E**mployees **R**etirement **S**ystem ● **C**ounty **E**mployees **R**etirement **S**ystem ● **S**tate **P**olice **R**etirement **S**ystem

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Funding Your Retirement

By William P. Hanes, Executive Director

Members of the 2004 Kentucky General Assembly began their sixty-day legislative session earlier this month in Frankfort. As legislators return to the Capitol, I want to extend my appreciation to the members of the General Assembly. Their actions have resulted in the excellent retirement program we enjoy today. Kentucky Retirement Systems is fortunate to have developed a very positive relationship with the General Assembly over the years, and I look forward to continuing that relationship in the upcoming session.

Of all the pressing issues facing legislators this session, without a doubt the most important is the difficult task of writing a state budget during these trying economic times.

In a nutshell, the budget problem the Commonwealth is currently experiencing is this: there is a finite amount of money in the budget, and legislators must decide how to best allocate that money to provide the same, or even better, level of services to the citizens of the Commonwealth.

These budget problems are important to you not only as a Kentuckian, but also as a member of Kentucky Retirement Systems (KRS). KRS receives a portion of the funding necessary to provide retirement benefits to our members through employer contribution rates allocated in the state budget. The requested rates are furnished to the legislature by the KRS Board of Trustees, who employ an independent consulting actuary to determine the funding levels necessary to maintain the financial integrity of the systems.

Unfortunately, for five of the last eleven years the state budget has not paid the actuarially recommended employer contribution rates for the Kentucky Employees Retirement System (KERS) and the State Police Retirement System (SPRS). To date, these reductions have resulted in a loss of over $126 million to the systems.

The KRS Board of Trustees strongly opposes any reduction in the actuarially recommended employer contribution rates. We believe it is not sound financial policy to continue to borrow against the future to pay the debts of today, and our primary focus this legislative session will be to sound the alarm to raise awareness of this crucial issue.

You can help by contacting your state representative and senator and asking them to support Kentucky Retirement Systems by fully funding the actuarially recommended contribution rates in the state budget. The very future of the systems will be put in even greater jeopardy if these reductions continue.

For your information, this newsletter contains several articles concerning the funding issues facing the retirement systems. I encourage you to read these articles so that you will be better informed on the issues that may arise in the 2004 legislative session.

Contribution Rates Requested

Kentucky Retirement Systems has requested the following employer contribution rates for the Kentucky Employees Retirement System (KERS) and the State Police Retirement System (SPRS) based upon recommendations from our consulting actuary:

System	2004-2005	2005-2006
❑ KERS Non-Hazardous:	10.29%	12.89%
❑ KERS Hazardous:	19.47%	21.46%
❑ SPRS:	28.08%	34.24%

Note: Contribution rates for the County Employees Retirement System (CERS) are not included in the state's biennial budget. CERS contribution rates for the 2004-2005 fiscal year will be 8.48% for non-hazardous employers and 22.08% for hazardous employers in CERS.

Contacting Your Legislator

For more information on contacting your legislator, please review the information below.

By Phone

You can leave a message for your legislator by dialing 1-800-372-7181.

By Mail

Mail a letter to a legislator C/O:
Legislative Research Commission
700 Capitol Ave.
Frankfort, Ky. 40601

Online Information

Visit the Legislative Research Commission (LRC) web site at www.lrc.state.ky.us

Budget Reductions to the Employer Contribution Rate

The Actuarial Valuation

The Board of Trustees has the unique responsibility of insuring that sufficient assets are available to fund your benefits during your retirement years. To help fulfill this responsibility, the Board hires an independent actuary to conduct an annual valuation of the retirement systems.

During the valuation, the actuary will review current plan provisions, membership data, and financial statistics in order to determine the actuarial liabilities and funded status of the systems. In doing so, the actuary will be able to determine the appropriate level of employer contributions necessary to fund benefits. Once completed, the actuary presents the finding and recommendations of the valuation to the Board of Trustees. Provided the Board approves the valuation, the Board will then notify employers of the contribution rates to be paid for the upcoming fiscal year, or in the case of KERS and SPRS, for the upcoming biennium. Since KERS and SPRS employer contributions are paid in part by General Fund dollars, legislative action is also necessary to incorporate these employer contribution rates into the biennial budget.

Reductions to KERS and SPRS Rates

For five of the last eleven fiscal years, the state budget has effectively reduced the employer contribution rate recommended by the KRS Board of Trustees and its consulting actuary. These reductions have resulted in an estimated $126 million in lost contributions and investment opportunities. In addition, these reductions have also worked to erode the funding levels of the systems and will require increased employer contributions in the years to come.

Not only do these rate reductions work to jeopardize the long-term funded status of the retirement systems, but also the ability of the systems to pay retirement benefits in the short-term. As recently as November 2003, the retirement systems were required to invade the principal balance of the KERS trust assets just to pay current benefits and health insurance costs for retirees. The necessity to invade the principal balance was due in part to the budgeted reductions to the KERS employer contribution rate.

Breakdown of the Rate Reductions

The historical reductions to the employer contribution rate for KERS and SPRS in the biennial budget are provided in the table below.

Figure 1: History of the Employer Rate Reductions to KERS and SPRS Employers

KERS Non-Hazardous Employers		
Fiscal Year	*Recommended Rate*	*Budgeted Rate*
1992-1993	8.66%	7.65%
1993-1994	8.66%	7.65%
1995-1996	8.75%	8.56%
2002-2003	5.89%	3.76%
2003-2004	7.53%	5.89%

KERS Hazardous Employers		
Fiscal Year	*Recommended Rate*	*Budgeted Rate*
1992-1993	17.55%	15.05%
1993-1994	17.86%	15.05%
1995-1996	18.05%	17.97%
1999-2000	18.91%	18.66%
2002-2003	18.84%	17.60%

SPRS Employers		
Fiscal Year	*Recommended Rate*	*Budgeted Rate*
1992-1993	21.84%	19.57%
1993-1994	21.84%	19.57%
1995-1996	23.05%	21.78%
1999-2000	25.26%	23.41%
2002-2003	21.58%	17.37%

Funding Insurance Benefits

Background

Access to adequate and affordable healthcare is an issue facing most Americans. In fact, a recent survey of the American Association of Retired Persons (AARP) showed that retirees were returning to the workforce due to needs for health insurance after retirement.

As a member of KRS, you are eligible for insurance benefits upon retirement. These benefits are protected by state statute and the Kentucky constitution. This is good news for you as you enter your retirement years. However, the task of funding retiree insurance benefits is becoming a major challenge for the systems. Unless adequate funding is secured both now and in future years, the financial stability of the insurance funds will be in jeopardy.

The Rising Cost of Insurance

Despite significant progress in recent years, the financial status of the insurance funds continues to be the major issue facing the retirement systems. As of June 30, 2003 the funding levels, or percent of actuarial assets to actuarial liabilities, of the insurance funds varied between a low of 25.4% for CERS and a high of 49.2% for SPRS (see Figure 2 below).

Figure 2: Insurance Funds: Percent Funded
Percent of Actuarial Assets to Actuarial Liabilities

Insurance Fund	Percent Funded
KERS	29.7%
CERS	25.4%
SPRS	49.2%

The unfunded liabilities of the funds, or the difference between the actuarial assets and actuarial liabilities, has also grown significantly in recent years due to the escalating cost of health care and budget reductions in the employer contribution rate. In fact, over the last four years the combined unfunded liabilities of the insurance funds for KERS, CERS, and SPRS have increased from $2.78 billion in 2000 to more than $4 billion as of June 30, 2003. Figure 3 below details the growth in unfunded liabilities of the insurance funds for each retirement system over the last four years.

Figure 3: Four Year Growth of Unfunded Liabilities for the Insurance Funds
In billions of dollars

System	06/30/00	06/30/01	06/30/02	06/30/03
KERS	$1.13	$1.42	$1.49	$1.67
CERS	$1.58	$1.95	$2.07	$2.32
SPRS	$.07	$.08	$.08	$.09
All Systems	$2.78	$3.45	$3.64	$4.09

Investment Performance

Asset Smoothing Method

Within the valuation process, actuarial assets are determined through a five year smoothing method. As a result, only 20% of any investment gains or losses are recognized in the year in which they occur. The remaining 80% of gains or losses are then spread equally over the next 4 years.

The rationale of the asset smoothing method is that over most 5-year cycles, there will be ups and downs in the investment return. Spreading the recognition of both investment gains and losses over a period of years results in a more stable long-term employer funding rate, and does not unduly increase or decrease that funding rate for a decrease or increase in plan market values in any one year.

Recent Investment Losses

KRS, along with almost every other public pension plan in the country, has experienced poor investment returns during the most prolonged bear market in more than sixty years (a three-year decline). While the market is showing signs of recovery, the effects of losses from previous fiscal years will continue to be felt due to the 5-year asset smoothing method. As of June 30, 2003, the amount of investment losses unrecognized from previous fiscal years totals more than $3.3 billion. In the absence of significant actuarial gains (returns above the assumed 8.25% rate of return) in the next 3-4 years, these losses will increase the level of contributions necessary to maintain the financial stability of the retirement systems.

The Rising Cost of Health Care

Insurance benefits for retirees of the systems were established by the 1978 General Assembly. Since that time the cost of coverage has grown significantly. The information below shows the cost of coverage in 1978 and for the 2004 plan year.

Level of Coverage	1978	2004
Single	$25.50	$286.16-$436.00*
Family**	$70.00	$643.92-$981.20***

* *Cost to provide an Option A PPO.*

** *An additional contribution is paid for eligible hazardous duty retirees.*

*** *Cost to provide an Option B PPO.*

One-on-One Conferences

The retirement systems will once again be holding one-on-one conferences at various locations through the state. These sessions give members the opportunity to meet individually with a Retirement Counselor to discuss retirement estimates, service purchases, and questions regarding individual retirement accounts. To reserve an appointment for a particular conference, please call the Employee Call Center at 1-800-928-4646, extension 4522. A schedule of the 2004 one-on-one conferences is provided on page 4.

2004 One-On-One Conference Schedule		
Seminar Date	**Conference Location**	**Call For Appointment Beginning**
Jan. 12-15, 2004	City of Louisville *Memorial Auditorium Ballroom*	*Conference is Full*
Feb. 9-12, 2004	City of Elizabethtown *Pritchard Community Center*	*Conference is Full*
Mar. 15-18, 2004	City of Bowling Green *Bowling Green Community Center*	Feb. 10, 2004
Apr. 19-22, 2004	City of Owensboro *Executive Inn Rivermont: Expo Center*	Mar. 16, 2004
May. 17-20, 2004	Jenny Wiley State Resort Park *May Lodge*	Apr. 13, 2004
June 14-17, 2004	Pennyrile State Resort Park	May 11, 2004
July 12-15, 2004	KY Dam Village State Resort Park	June 8, 2004
Aug. 16-19, 2004	Lake Cumberland State Resort Park *Lure Lodge*	July 13, 2004
Sep. 13-16, 2004	Pine Mountain State Resort Park *Evans Lodge*	August 10, 2004
Oct. 11-14, 2004	City of Florence *Florence Government Center*	September 7, 2004
Nov. 15-18, 2004	City Of Ashland *Kentucky Educational Development Corporation*	October 12, 2004
Dec. 13-15, 2004	Natural Bridge State Resort Park *Hemlock Lodge*	November 9, 2004

Remember: You must make an appointment for the One-On-One Conferences.

www.kyret.com

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This newsletter contains important information about your KRS benefits.